

Liquidated Damages Clauses - Enforceable or Penal?

Philips Hong Kong Limited v The Attorney General of Hong Kong, unreported, Privy Council, 9 February 1993.

In a case decided on 9 February 1993, the Privy Council was called to decide whether a liquidated damages clause in a substantial road works contract between the Hong Kong Government and the road works contractor (Philips Hong Kong Limited) was enforceable or if was not able to be relied on by the Government as a "penalty". The contract works were for the design and construction of approach roads and tunnels in the New Territories. The contract was one of a series of seven interrelated contracts let by the Government relating to the particular development and was in the value of HK\$51 million.

The contract imposed a liability upon Philips to pay liquidated damages at a daily rate for failures to meet any of the key dates, specified for different stages of work which were required to be met for the other contracts, and also to pay further liquidated damages at a daily rate if the total contract works were not completed within a specified period.

Relying on a long line of decisions which require liquidated damages clauses in contracts to be a genuine pre-estimate (at the time of making of the contract) of the damages likely to be suffered as a result of the delay, Philips argued that the liquidated damages clause was a penalty and was not enforceable. In particular, the contractor argued that the clause was a penalty because it could operate so that Philips would be paying double the actual loss suffered by the Hong Kong Government as a result of delay as the liquidated damages were payable for both failing to meet key dates and failing to meet the overall completion date.

The Court did not agree with Philips' arguments and held that the liquidated damages clause was enforceable even through its application in the particular facts of the case might result in the Hong Kong Government recovering damages far greater than their actual loss as a result of the delay. The Court was of the view that just because it was theoretically possible to devise examples where the liquidated damages figure would be far greater than the actual damages suffered, that was not sufficient to strike the clause out as being a penalty. The Court said:

"Such a result would undermine the whole purpose of the parties to a contract being able to agree beforehand what damages are to be recoverable in the event of a breach of contract. This would not be in the interest of either of the parties to the contract since it is to their advantage that they should be able to know with a reasonable degree of certainty the extent of their liability and the risks they run as a result of entering into the contract. This is particularly true in the case of the building and engineering contracts".

The Privy Council's decision makes it clear that prior to agreeing to a liquidated damages clause and the amounts contained in the clause contractors need to consider carefully whether the clause could operate unfairly and consider whether they should be agreeing to a clause which operates in that manner. There is little prospect of having a liquidated damages clause declared unenforceable as being a penalty in view of the court's stated reluctance to disturb the operation of such clauses except in cases where the clause clearly does not represent a genuine pre-estimate at the time of signing the contract of the damages likely to be suffered in the event of a delay.

- **Jeffrey Wilson, Partner, Sly & Weigall, Melbourne. Reprinted with permission from Sly & Weigall's Critical Path.**